

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
KEALIA WATER COMPANY HOLDINGS LLC)
For a Certificate of Public)
Convenience and Necessity to)
Provide Water Services on the)
Island of Kauai, District of)
Kealia, and for Approval of Rules,)
Regulations, and Rates.)
_____)

DOCKET NO. 03-0246

DECISION AND ORDER NO. 21992

RECEIVED
2005 AUG 17 A 8:25
DIV. OF CONSUMER ADVOCACY
DEPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

Filed August 16, 2005
At 10 o'clock A.M.

for Brooke K. Kane
Chief Clerk of the Commission

ATTEST: A True Copy
BROOKE K. KANE
Administrative Director
Public Utilities Commission
State of Hawaii
Brooke K. Kane

TABLE OF CONTENTS

I.	BACKGROUND	1
	A. Procedural History	1
	B. Kealia Water and its Proposed Service	5
II.	ISSUES	7
III.	PARTIES' STIPULATION	8
IV.	CPCN DETERMINATION	9
V.	INITIAL RATES AND TERMS OF SERVICE	12
	A. Stipulated Initial Rates	12
	B. Stipulated Revenues	17
	C. Stipulated Operating Expenses	18
	D. Stipulated Tax and Depreciation Expenses	20
	E. Stipulated Rate Base and Related Issues	22
	1. CIAC, Rate Base, and OAC	23
	2. Stipulated Water System Facilities Charge	24
	3. Other Stipulated Related Matters	26
	F. Stipulated Rate of Return	26
	G. Stipulated Rules and Regulations	27
VI.	ULTIMATE FINDINGS AND CONCLUSIONS	29
VII.	ORDERS	31
	EXHIBIT I	

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)	
KEALIA WATER COMPANY HOLDINGS LLC)	Docket No. 03-0246
For a Certificate of Public)	
Convenience and Necessity to)	Decision and Order No. 21992
Provide Water Services on the)	
Island of Kauai, District of)	
Kealia, and for Approval of Rules,)	
Regulations, and Rates.)	
<hr/>	

DECISION AND ORDER

By this Decision and Order, the commission: (1) grants KEALIA WATER COMPANY HOLDINGS LLC ("Kealia Water" or "Applicant") a certificate of public convenience and necessity ("CPCN") to provide water service within its proposed service area in the District of Kealia, on the island of Kauai; and (2) approves Kealia Water's initial rules, regulations, and rates for service.

I.

BACKGROUND

A. Procedural History

Kealia Water seeks a CPCN authorizing it to provide water service on the island of Kauai, District of Kealia; and commission approval of its proposed rates, rules, and regulations.¹ Kealia Water's Application was filed pursuant to

¹Kealia Water filed its Application, Exhibits "KWC-101" through "KWC-119" and certain specific filing requirements on August 29, 2003, and then filed updated exhibits to its

Hawaii Revised Statutes ("HRS") §§ 269-7.5 and 269-16 and Hawaii Administrative Rules ("HAR") §§ 6-61-74 and 6-61-75.

The DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate") was served copies of Kealia Water's Application.² Notice of Kealia Water's CPCN Application was published on November 13, 2003, pursuant to HAR § 6-61-57(2).³

KEALIA PLANTATION COMPANY, LLC ("Kealia Plantation") filed a motion to intervene as a party to this proceeding⁴ on December 3, 2003 ("Motion").⁵ The commission granted

Application on August 23, 2004, and October 1, 2004 (collectively, the "Application").

²The commission issued Order No. 20595 on October 28, 2003, requiring Kealia Water and the Consumer Advocate to file a stipulated schedule within thirty (30) days of the issuance of the Order. Later, however, the filing requirements of Order No. 20595 were suspended until further order of the commission. See, Order No. 20670, filed on November 24, 2003.

³HAR § 6-61-57(2) requires a motion to intervene or participate in a proceeding regarding an application for the issuance or transfer of a CPCN to be filed not later than twenty (20) days after the notice of the pending application is published.

⁴No other persons moved to intervene in this proceeding.

⁵On December 12, 2003, Kealia Water filed a memorandum in opposition to the Motion ("Opposition"). Kealia Plantation filed a letter on December 19, 2003, requesting leave to submit its reply to the Opposition ("Leave Request"), as incorporated ("Reply" or "Letter"). By letter filed on December 29, 2003, Kealia Water objected to the submission of the Reply and requested that the commission strike the Letter from the record ("Strike Request"), or in the alternative, provide additional time for Kealia Water to submit substantive responses to the issues raised in the Reply ("Response"). The commission in Order No. 20743, filed on January 8, 2004: (1) denied Kealia Water's Strike Request; (2) granted Kealia Plantation's Leave Request; and (3) established filing procedures for Kealia Water to submit its Response and for Kealia Plantation, at its option, to file its reply comments to the Response

Kealia Plantation's Motion in Order No. 20970, filed on May 12, 2004, and required Applicant, the Consumer Advocate, and Kealia Plantation (or "Intervenor") (collectively, the "Parties") to submit a stipulated prehearing order or, if unable to stipulate, separate proposed prehearing orders within thirty (30) days of the date of Order No. 20970.⁶

The Parties filed their Proposed Stipulated Prehearing Order on July 22, 2004.⁷ The Parties' proposed Stipulated Protective Order was filed on July 29, 2004. The commission issued Stipulated Prehearing Order No. 21217 ("Prehearing Order") and Protective Order No. 21216 ("Protective Order") on August 5, 2004.

Pursuant to the Prehearing Order, Kealia Water filed its Direct Testimony and Exhibits and its responses to the Consumer Advocate's first set of information requests ("IRs")⁸ on August 4, 2004.⁹ Further extensive discovery of the issues of Kealia Water's Application was conducted in accordance with the

("Comments"). Kealia Water filed its Response on January 15, 2004, and Kealia Plantation filed its Comments on January 22, 2004, pursuant to Order No. 20743.

⁶By Order Nos. 21082 and 21102, issued on June 25, 2004 and July 2, 2004, respectively, the commission approved the Parties' extension requests filed on June 10, 2004 and June 25, 2004, respectively, extending the deadline for the filing of the Parties' proposed stipulated prehearing order to July 23, 2004.

⁷Replacement pages to the Parties' proposed Stipulated Prehearing Order were submitted on July 28, 2004.

⁸Applicant filed the confidential portions of its responses to the Consumer Advocate's first set of IRs on August 23, 2004 under the Protective Order.

⁹The Consumer Advocate had issued its first set of IRs on December 26, 2003.

Prehearing Order, through: (1) the issuance of the Consumer Advocate's second set of IRS and Kealia Plantation's initial IRS on Kealia Water on September 3, 2004, for which Kealia Water's responses were filed on September 23, 2004; and (2) the issuance of the Consumer Advocate's and Kealia Plantation's supplemental IRS on Kealia Water on October 14, 2004; for which Kealia Water's responses were filed on October 28, 2004. With the commission's leave, the Parties amended their Stipulated Regulatory Schedule to permit Kealia Plantation and the Consumer Advocate to file their Testimony and Direct Testimony and respective Exhibits on December 29, 2004, and January 4, 2005, respectively.

Through a joint letter filed on January 14, 2005, the Parties informed the commission of their agreement to further amend the Stipulated Regulatory Schedule in an attempt to provide the Parties with an opportunity to settle the disputed issues.¹⁰ The Parties further advised the commission that upon reaching an agreement, the schedule would be revised to allot time for the filing of a stipulated settlement agreement; however, if no agreement was reached, the Parties would continue on with the remaining steps of their Stipulated Regulatory Schedule.

The Stipulation of the Parties in Lieu of Evidentiary Hearing, including Exhibits "A" through "C", were filed on

¹⁰The Parties filed their January 14, 2005 letter whereby they essentially agreed to suspend the Stipulated Regulatory Schedule to conduct settlement discussions, pursuant to Article II of the Stipulated Prehearing Order which states, in part that "the [P]arties shall have the right to amend the Stipulated Regulatory Schedule as may be agreed in writing from time to time." See, Stipulated Prehearing Order at 4.

June 9, 2005 (collectively, "Stipulation") memorializing, among other things, the Parties' "global resolution of all the issues in the subject docket;" and their agreement that an evidentiary hearing on the issues of this docket is not necessary and that this matter is ready for decision making.¹¹ Additionally, on June 9, 2005, Applicant submitted its Testimony and Exhibits in Support of Stipulation. By joint letter filed on June 14, 2005, the Parties informed the commission that no additional filings would be made in the docket and that the matters of the docket were ready for commission resolution.

B. Kealia Water and its Proposed Service

Applicant, Kealia Water, is a Delaware limited liability company ("LLC") whose principal place of business is in Kapaa, Kauai. Kealia Water was formed on June 24, 1998, and is: (1) registered as a foreign LLC in the State of Hawaii ("State"); and (2) authorized to conduct business in the State. Kealia Water is a fully owned subsidiary of Cornerstone Hawaii Holdings LLC ("Cornerstone"), a Delaware LLC.

Kealia Water was formed to own and operate the old potable water system on the lands purchased in 1997 from The Lihue Plantation Company, Limited ("Lihue Plantation"). The land was purchased by affiliates of Kealia Water, Kealia Makai Holdings LLC ("Kealia Makai") and Kealia Mauka Holdings LLC for residential development. The old water system provided service to two (2) existing subdivisions developed by

¹¹See, Stipulation at 3.

Lihue Plantation comprised of sixty-one (61) residences; and two (2) businesses (the general store and a rodeo facility) (collectively, "Existing Subdivision"). The old water system was very aged, extremely dilapidated, and did not meet current water system standards. Due to these problems, Kealia Water replaced the old water system with a new system in 2001. Specifically, Kealia Water, among other things, replaced two (2) wells and constructed: (a) two (2) 67,000 gallon water steel storage tanks; (b) water delivery lines; and (c) a sodium hypochlorite system approximately within the same location as the old system.¹² The new water system cost \$1,689,263¹³ and has a daily pumping capacity of approximately 936,000 gallons of water. Customers situated in and around the Existing Subdivision are currently provided water service through the new system, which is being operated and maintained by Aqua Engineers, Inc. ("Aqua"), a company that operates and maintains water and wastewater systems in the State.¹⁴ Applicant is currently not metering water use; and has indicated in the record that it will not bill customers for services rendered prior to obtaining its CPCN.¹⁵

¹²A detailed description of Kealia Water's infrastructure and equipment is set forth in Exhibits KWC-106, KWC-107, and KWC-108 of the Application.

¹³In its Application, Kealia Water initially stated that \$1,839,263 was expended to replace the old Lihue Plantation water system. Kealia Water reduced its initial cost figure by \$150,000 to remove the cost for the irrigation system, which it stated should not have been included in its initial calculations. See, Applicant's response to CA-IR-6.

¹⁴See, Exhibit KWC-109 of the Application.

¹⁵See, Stipulation at 16 and Applicant's response to INT-IR-49.

Kealia Makai, owned by Cornerstone, is developing a new subdivision consisting of thirty-five (35) new residences on oceanfront agricultural lands purchased from Lihue Plantation located "makai" of Kuhio Highway named Kealia Kai. Kealia Water is seeking a CPCN, among other things, to provide, administer, and operate the new water system and provide water service to customers in: (1) the Existing Subdivision, (2) Kealia Kai, and (3) any future developments in the lands purchased from Lihue Plantation ("Proposed Service Area").¹⁶

II.

ISSUES

As set forth in the Prehearing Order, the stipulated issues of this proceeding are as follows:

1. Is Kealia Water fit, willing, and able properly to perform the service proposed and to conform to the terms, conditions, and rules adopted by the commission?
2. Is the proposed service required by the present or future public convenience and necessity?
3. Are Kealia Water's proposed rates reasonable?
 - (a) Are the proposed tariffs, rates, rules and charges just and reasonable?

¹⁶Kealia Water's geographic scope of service is specifically depicted in Exhibits KWC-101 through KWC-103 of the Application.

- (b) Are the revenue forecasts for the test year ending July 31, 2004 ("Test Year") at present and proposed rates reasonable?
- (c) Are the projected operating expenses for the Test Year reasonable?
- (d) Is the projected rate base for the Test Year reasonable, and are the properties included in the rate base used or useful for public utility purposes?
- (e) Is the rate of return requested fair?

III.

PARTIES' STIPULATION

The Stipulation formally memorializes the Parties' global resolution of the issues of this docket and states that "[e]ach provision of this Stipulation is in consideration and support of all other provisions, and is expressly conditioned upon acceptance by the [c]ommission of the matters expressed in this Stipulation in their entirety."¹⁷ The Parties maintain that they have "stipulated to the various rate components and matters discussed in the following sections [of the Stipulation] below as being appropriate, without necessarily agreeing on the underlying methodologies or justifications asserted by the other Parties."¹⁸ The Parties filed the Stipulation in lieu of an evidentiary hearing and expressly waived the filing of briefs, provided that

¹⁷See, Stipulation at 32.

¹⁸See, Stipulation at 7.

the commission accepts the Stipulation. However, the Parties reserve their right to pursue any and all of their respective positions through further negotiations and proceedings before the commission in the event that the commission declines to adopt all or various parts of the Stipulation. The Parties further agree that "all filed testimony, exhibits, information requests, and responses are part of the record of this docket" and acknowledges that the Stipulation is subject to the commission's review and approval.¹⁹

Through this proceeding, the commission will, among other things, establish Kealia Water's initial rates. "In this regard, it is well-settled that an agreement between the parties in a rate case cannot bind the commission, as the commission has an independent obligation to set fair and just rates and arrive at its own conclusion."²⁰ We will conduct our review of the various provisions of the Stipulation under this general directive.

IV.

CPCN DETERMINATION

Under HRS § 269-7.5, to obtain a CPCN Kealia Water must demonstrate that it is fit, willing, and able to properly perform the water service it proposes to provide; conform to the terms,

¹⁹See, Stipulation at 32.

²⁰Decision and Order No. 21864, filed on June 14, 2005, in Docket No. 04-0298 (*In re North Shore Wastewater Treatment, L.L.C.*) at 13 (citing *In re Hawaiian Elec. Co., Inc.*, 5 Haw. App. 445, 698 P.2d 304 (1985)).

conditions, and rules adopted by the commission; and that its proposed service is, or will be, required by the present or future public convenience and necessity.²¹

Kealia Water represents that it has no financial encumbrances and debts²² and that Cornerstone "will continue to provide financial support to fund the shortfalls" in the event that Kealia Water experiences operating losses.²³ In its written submissions, the Consumer Advocate concludes that Kealia Water is financially fit to provide the water service being proposed and expresses its satisfaction with Cornerstone's financial ability to support Kealia Water during times of operating losses and Cornerstone's commitment to provide such support.²⁴

In addition, the Parties: (1) stipulate that Kealia Water is fit, willing, and able to properly perform as a water utility; conform to the terms, conditions, rules, and regulations adopted by the commission; and that Kealia Water's proposed services are, or will be, required for the present and future public convenience and necessity; and (2) conclude that Kealia Water should be granted a CPCN subject to the conditions set forth in the Stipulation.²⁵

²¹HRS 269-7.5 requires the commission to also determine the reasonableness of the Kealia Water's proposed rates, charges, and tariff rules and regulations under the standards of HRS § 269-16 in the CPCN proceeding.

²²See, Application at 5.

²³See, Applicant's Response to CA-IR-2(c).

²⁴See, Consumer Advocate's Direct Testimony at 4-7.

²⁵See, Stipulation at 12.

Kealia Water replaced the old Lihue Plantation potable water system with a new system, and contracted with Aqua to maintain and conduct the day-to-day operations of the new water system. Aqua is an experienced operator of water and wastewater systems in the State since being founded in 1981.²⁶ Since Aqua was retained in 2002 to operate and maintain the water system, Kealia Water has not received any customer complaints or notices of violation from the State Department of Health regarding its services.²⁷ The Consumer Advocate concludes that Applicant's water system will be able to properly perform as a water utility and has the capacity to adequately meet the demand for water service.²⁸ Kealia Water represents that the County of Kauai does not provide municipal water service in the area and that no other private water utility provides service in the area;²⁹ thus, Applicant is the sole provider of water service in its Proposed Service Area, an area where demand for service is expected to increase through new developments such as Kealia Kai.

Upon review, the commission finds that Kealia Water has satisfied the statutory requirements of HRS § 269-7.5.

²⁶The Consumer Advocate notes in its Direct Testimony that it is aware that Aqua has operated and maintained systems for Puhi Sewer and Water Company, Kuilima Resort Company, and Schofield Barracks. See, Consumer Advocate's Direct Testimony at 13-14. Evidence regarding Aqua's experience in the field of maintaining and operating water and wastewater systems in the State was also provided by the Applicant. See, Exhibit KWC-109 of the Application.

²⁷See, Applicant's Response to CA-IR-30.

²⁸See, Consumer Advocate's Direct Testimony at 12-14.

²⁹See, Applicant's Response to CA-IR-11.

Our determination is based on the record established by the Parties to this docket including, but not limited to, the various representations made by Kealia Water in this proceeding, of which some are expressly noted above. Accordingly, the commission concludes that Kealia Water should be granted a CPCN to provide water service in the District of Kealia, on the island of Kauai in the Proposed Service Area as described in its Application; provided that Applicant adheres to the regulatory requirements set forth in Section VII of this Decision and Order.

V.

INITIAL RATES AND TERMS OF SERVICE

A. Stipulated Initial Rates

Kealia Water intends to recover its operating expenses during the Test Year, and upon completion of the Kealia Kai subdivision in 2006 ("Full Build-Out") recover its operating expenses and earn a return on its investment through its proposed initial rates.³⁰ The rates stipulated to by the Parties are based on Test Year revenue requirements, which are detailed in the sections below. The estimates of rate elements at Full Build-Out within the Stipulation and discussed in the sections below, are, as expressed by the Applicant, "to show that the proposed rates would not provide an excessive rate of return when the build out of Kealia Kai Subdivision is completed [i.e. upon Full Build-Out]." ³¹

³⁰ See, Applicant's Direct Testimony at 8.

³¹ See, Applicant's Direct Testimony at 10.

At the onset of this proceeding, Kealia Water proposes to assess: (1) a standard monthly service charge of \$9.50; and (2) to promote conservation, a two (2) tier volumetric rate based on usage per month for its water service. The two (2) tier volumetric rate consists of a rate of \$5.00 per thousand gallons ("TG") assessed to customers for water usage up-to 15,000 gallons (or 15 TGs) per month; and a \$6.25 per TG rate for usage over 15,000 gallons per month.

Applicant bases its conservation rate on the average consumption rate for water customers in the County of Kauai, which is reported to be 12,700 gallons per month, and grossed-up this amount by approximately twenty (20) percent to account for any variances to obtain its threshold usage level of 15,000 gallons per month.³² Kealia Water did not utilize a study to determine whether its rate proposal would achieve its conservation objectives; however, Applicant states that it plans to collect and develop customer usage patterns upon receiving its CPCN, which it intends to use to either validate its initial tiered rate proposal or to propose new levels during its next rate case proceeding.³³

The Consumer Advocate states that a "traditional review of the derivation of Applicant's proposed rates is difficult and impractical to perform at this time" since historical data is lacking and due to the developing nature of Applicant's customer

³²See, Stipulation at 14.

³³*Ibid.*

base.³⁴ Thus, it does not oppose approval of Kealia Water's proposed volumetric rates, at this time; however, it cautions that the reasonableness of Applicant's tiered rates will need to be re-examined during its next rate proceeding.³⁵ With regards to Applicant's monthly service fee, however, the Consumer Advocate recommends that Kealia Water's standard monthly service fee of \$9.50 be adjusted based on meter size. The adjustment would account for the ability of larger meters to provide a greater volume of water. A chart of the Consumer Advocate's recommendation regarding this fee is set forth on page 39 of its Direct Testimony. The Consumer Advocate reasons that a customer requesting a larger meter due to the customer's expectation to consume more water, should be "responsible for a proportionally larger amount of the fixed costs incurred to produce the water. . . . to reflect that a larger portion of the plant is being made available to serve that customer in comparison to a customer with a smaller meter."³⁶ The Consumer Advocate states that further refinement and verification of the reasonableness of the monthly service fee is limited due to the lack of a cost of service study for Applicant's water service. Moreover, the Consumer Advocate recommends that Kealia Water be required to file annual financial reports upon receipt of its CPCN to monitor Applicant's operations and to ensure that the authorized rates do not result

³⁴See, Consumer Advocate's Direct Testimony at 40.

³⁵See, Consumer Advocate's Direct Testimony at 40-1.

³⁶See, Consumer Advocate's Direct Testimony at 39.

in excessive profits.³⁷ Kealia Water is not opposed to the Consumer Advocate's recommendation regarding monthly service fees³⁸ and Kealia Plantation did not raise any objections to the rates proposed.³⁹

The Parties stipulated to adopt the two (2) tier volumetric rate initially proposed by Kealia Water and the Consumer Advocate's recommendation to assess monthly service fees in accordance with meter size, set forth in its Direct Testimony. Accordingly, the Parties agreed to the following volumetric and monthly service charges for Applicant's water service (collectively known hereafter as "Stipulated Rates"):

VOLUMETRIC RATE/TG:

Usage Amount	Volumetric Rate/TG
0 - 15,000 gallons	\$5.00
15,001 - above gallons	\$6.25

MONTHLY SERVICE FEES:

Meter Size	Meter Maximum gallons per minute	Monthly Service Fee
0.75	25	\$9.50
1.00	35	\$13.00
1.50	70	\$27.00
2.00	115	\$44.00
2.50		\$68.00
3.00	240	\$91.00
4.00	450	\$171.00
6.00	910	\$346.00
8.00		\$616.00

³⁷See, Consumer Advocate's Direct Testimony at 42 and 51.

³⁸See, Stipulation at 15.

³⁹*Ibid.*

While the Parties' Stipulated Rates are somewhat higher than those charged by the County of Kauai,⁴⁰ Kealia Water's explanation that its operating costs and limited customer base (in relation to the County of Kauai) justified its higher rates⁴¹ appears to be reasonable. A review of the Parties' stipulated Revenue Requirement and Rate of Return schedule, attached as Exhibit A to the Stipulation, indicates that under the Stipulated Rates, Applicant will be operating at a loss during the Test Year and may continue to experience operating losses until Full Build-Out.⁴² As the Consumer Advocate advises, a traditional review of Kealia Water's proposed rates will be impractical and very difficult at this time since there is little historical information to support adjustments. The commission finds the Consumer Advocate's recommendation to require Kealia Water to file annual financial reports with the commission and the Consumer Advocate to be reasonable, and concludes that this recommendation should be adopted. Through these annual financial reports, the commission and the Consumer Advocate will have the opportunity to monitor Kealia Water's operations under

⁴⁰The Consumer Advocate placed the County of Kauai's water rates into the record of this proceeding. See, Consumer Advocate's Direct Testimony at 16.

⁴¹See, Applicant's Response to CA-IR-12(d).

⁴²Specifically, during the Test Year, Kealia Water is expected to be operating at a negative net income of approximately \$11,000. See, Stipulation Exhibit A.

the Stipulated Rates and, if warranted, take necessary action under the commission investigatory powers under HRS §§ 269-7(a).⁴³

Based on the above, the commission finds the Parties' Stipulated Rates, as set forth above, to be acceptable for the purposes of this docket. The rate elements that support and "justify" the Parties' Stipulated Rates are discussed below.

B. Stipulated Revenues

Kealia Water initially forecasted revenues of \$69,297 for the Test Year and \$108,189 at Full Build-Out. It based its calculations on an estimate of sixty-eight (68) customers in the Existing Subdivision and seven (7) customers in Kealia Kai during the Test Year; and an increase to thirty-five (35) customers in the new subdivision at Full Build-Out. For customers in the Existing Subdivision, Kealia Water estimated monthly average usage of 12,700 gallons per month, which is the average monthly consumption figure for customers in Kauai; for Kealia Kai customers it utilized the higher figure of 20,000 gallons per month since usage in the new subdivision is expected to be higher due to the larger sizes of the lots.⁴⁴

⁴³HRS § 269-7(a) provides the commission with the power to examine the condition of a public utility, the manner in which it is operated with reference to, among other things, the issuance by the utility of stocks and bonds, and the disposition of the proceeds thereof, the amount and disposition of its income, and all its financial transactions, its business relations with other persons, companies, or corporations, . . . and all matters of every nature affecting the relations and transactions between it and the public or persons or corporations.

⁴⁴Due to the larger lots, Kealia Water anticipates homeowners in Kealia Kai to build larger than average homes and additional cottages on their lots.

Alternatively, the Consumer Advocate projected revenues of \$57,966 for the Test Year and \$109,935 at Full Build-Out. While the Consumer Advocate accepted Kealia Water's water usage estimates; it disagreed somewhat with Kealia Water's estimated number of customers. The Consumer Advocate based its projections on an estimate of sixty-three (63) customers in the Existing Subdivision and two (2) customers in Kealia Kai during the Test Year, and an increase to seventy (70) customers in the Existing Subdivision and an overall count of thirty-five (35) customers in Kealia Kai at Full Build-Out. In the Stipulation, the Parties agreed to the Consumer Advocate's calculated revenue estimates at Test Year and at Full Build-Out.

Upon review, we find the agreed-upon revenue estimates of \$57,966 for the Test Year and \$109,935 at Full Build-Out, as set forth in the Stipulation, to be acceptable for the rate-setting purposes of this docket.

C. Stipulated Operating Expenses

The Parties stipulated to the following operating expense estimates for Kealia Water's Test Year:

1.	Operations Contract	\$17,400
2.	Electricity Expense	\$ 7,000
3.	Insurance	\$13,650
4.	Materials and Supplies	\$ 1,000
5.	Legal and Regulatory	\$ 3,400
6.	Administrative Expense	\$12,000
7.	Miscellaneous Expenses	\$ 2,000

Except for electricity expense, the Parties adopted Kealia Water's initial expense projections as their stipulated operating expense estimates. Kealia Water developed its initial operating expense estimates based on actual expenses and projections of expenses based on its estimated number of customers during the Test Year; however, Kealia Water opted not to develop pro forma operating expense projections at Full Build-Out.⁴⁵

While Kealia Plantation did not object to any of the Kealia Water's operating expense projections, the Consumer Advocate expressed some overall concerns. The Consumer Advocate contends that "as a start-up entity, Applicant has little, if any, historical data to support the test period expense estimates and resulting proposed rates since the proposed service has [not] yet begun."⁴⁶ Accordingly, the Consumer Advocate states that there would be very little support to recommend adjustments to Kealia Water's operating estimates.⁴⁷ The only substantive adjustment that the Consumer Advocate proposes regarding Kealia Water's operating cost estimates is for electricity expense. For this cost item, the Consumer Advocate adjusts Kealia Water's initial estimate of \$10,021 for non-recurring

⁴⁵Applicants decided not to develop operating expense projections at Full Build-Out since it believed that doing so would: (1) increase total revenue requirements for that period; and (2) raise unnecessary issues for the matters of this docket. Moreover, they stressed that the rates proposed in this docket were based on revenue requirements for the Test Year, and not for those at Full Build-Out. See, Stipulation at 16.

⁴⁶See, Consumer Advocate's Direct Testimony at 19-20.

⁴⁷See, Consumer Advocate's Direct Testimony at 20.

usage during certain months of the Test Year and recommends utilizing an allowance of \$7,000, which was adopted by the Parties.⁴⁸

The commission recognizes that historical information regarding operating expenses is lacking which limits traditional ratemaking review of some of these cost items. However, where available, we are aware that actual costs were utilized as Kealia Water's operating expense estimates. For example, the stipulated amount for "Operations Contract" expense of \$17,400 represents compensation payable to Aqua for the operations and maintenance of Applicant's water system during the Test Year.⁴⁹

Based on the above, the commission finds the Parties' stipulated Test Year operating expense estimates, as set forth in the Stipulation, and above, to be acceptable for the purposes of this docket.

D. Stipulated Tax and Depreciation Expenses

The Parties stipulated to "Taxes Other than Income Taxes" for the Test Year of \$3,701 and \$7,019 at Full Build-Out. The Parties also agreed to stipulate to \$5,851 for "Income Taxes" at Full Build-Out and no amount for this item in the Test Year. The stipulated tax expense amounts were derived from the Parties'

⁴⁸See, Stipulation at 17.

⁴⁹Under the Service Contract between Kealia Water and Aqua, Aqua is entitled to receive \$1,450 per month for services rendered under the contract (\$1,450 per month multiplied by 12 months equals \$17,400). See, Applicant's Response to CA-IR-9, Exhibit 1 at page 2 of 13.

stipulated amounts for revenue and operating expenses for the Test Year and at Full Build-Out.

With regards to depreciation expense, Kealia Water proposed an estimated gross figure of \$64,717 for the Test Year based on, among other things, using a twenty-five (25) year depreciation life for Applicant's two (2) wells. The Consumer Advocate proposed that the depreciable life of the wells be changed from twenty-five (25) to forty (40) years after consulting with engineers from the Honolulu Board of Water Supply and Kauai Department of Water, reducing annual depreciation expense of the wells to \$58,968.⁵⁰ The Consumer Advocate then proposed that \$50,182 of this amount be classified as advances-in-aid-of-construction ("AIAC"), resulting in a net depreciation expense for the Test Year of \$8,787. The Parties agreed to accept the Consumer Advocate's adjustments to Kealia Water's initial depreciation expense calculation and stipulated to an annual depreciation expense estimate of \$8,787 for the Test Year and at Full Build-Out.

These stipulated Test Year tax and depreciation cost estimates set forth above appear to be appropriate for the purposes of this docket since they are based on the stipulated revenue and operating expenses and other stipulated matters for Applicant's water service during the Test Year. Accordingly, we find these stipulated tax and depreciation expenses, as set forth in the Stipulation, and above, to be acceptable for the purposes of setting Kealia Water's initial rates.

⁵⁰ See, Consumer Advocate's Direct Testimony at 21.

E. Stipulated Rate Base and Related Issues

For the purposes of this rate proceeding, the Parties stipulate to an average rate base of \$282,835 for the Test Year and \$266,113 at Full Build-Out. Specifically, the Parties stipulate that: (1) Kealia Water's total cost of plant of \$1,689,263 is reasonable; and (2) Kealia Water's plant be allocated between the following rate categories: (a) rate base, (b) contribution-in-aid-of-construction ("CIAC"), and (c) AIAC or otherwise known as owner-advances-for-construction⁵¹ ("OAC").⁵² The Parties' agreement with regards to the various rate base elements is set forth on Exhibit B of the Stipulation.⁵³

Upon full review of the Stipulation and the record established in this docket, we find the Parties' stipulated rate base for the Test Year and at Full Build-Out and the various rate base elements and related matters including, but not limited to, the Parties' stipulation for a Water System Facilities Charge

⁵¹The Parties agreed to rename the AIAC account OAC to clearly identify that Kealia Water's owner provided the funds for the initial construction of the plant as opposed to a developer or customer. See, Stipulation at 23.

⁵²See, Stipulation at 21.

⁵³A slight discrepancy exists between the Exhibits submitted by the Parties, which were incorporated in the Stipulation, with regards to their stipulated rate base estimate for the Test Year. In Exhibit A of the Stipulation, the Parties have an "Average Rate Base" estimate of \$282,835 for the Test Year while in Exhibit B of the Stipulation; the Parties have a Test Year rate base estimate of \$282,836. The commission believes that the \$1 discrepancy is not substantial, is insignificant, and should not affect the overall matters of this docket. For the record, the figure the commission will view as the Parties' stipulated rate base for the Test Year is that of \$262,835, the figure used to calculate the Parties' "Revenue Requirements and Rate of Return" schedule, as set forth in Exhibit A of the Stipulation.

("WSFC") in the amount \$3,700 (as fully described in Exhibit B and pages 21 through 31 of the Stipulation) to be acceptable for the purposes of establishing Kealia Water's initial rates. The Parties' agreement regarding rate base elements and related matters are detailed below.

1. CIAC, Rate Base, and OAC

On the outset, Kealia Water proposes that the portion of Applicant's plant attributable to distribution facilities within Kealia Kai, an amount of \$264,243, be contributed to the water system and be treated as CIAC. Moreover, Kealia Water plans to require other new subdivisions developed in its Proposed Service Area to install distribution facilities and contribute them to the water system as CIAC. The Parties agreed to classify the cost of Kealia Kai's distribution facilities as CIAC.

With regards to rate base and OAC, upon negotiations, the Parties stipulated to allocate twenty-nine and forty-five hundredths of a percent (29.45%) of the water system's costs for production, storage, and transmission ("PST") to rate base and seventy and fifty-five hundredths of a percent (70.55%) to OAC. Specifically, the Parties agreed to allocate \$103,213 of PST plant costs to the Existing Subdivision and Kealia Kai at Full Build-Out; \$259,821 of PST plant costs to the Proposed Service Area, and \$869,804 of the PST plant costs to OAC.⁵⁴ Based on the Parties' rate base negotiations, the Parties state that Kealia Water will be allowed to recover a rate of return of

⁵⁴ See, Stipulation at 25.

approximately ten percent (10%) at Full Build-Out, and Applicant's owners will be allowed to recover seventy and fifty-five hundredths of a percent (70.55%) of the cost of the plant from the developers in the Proposed Service Area as lots are sold, as opposed to through higher water rates for customers. Moreover, the Parties stipulate to the following:

- (a) The unamortized balance in the OAC will be deducted from the Rate Base until payment is made through the use of a new charge called the WSFC for the first two hundred and thirty-five (235) service connections made to Applicant's water system (not applicable to the Existing Subdivision).
- (b) Once payment of WSFC is made by the developers, this amount will be transferred to CIAC where it will continue to be deducted from Rate Base.
- (c) If the projected level of future development resulting in connections to the system is not fully realized, the full amount of the OAC will not be paid and will remain as a rate base deduction.

2. Stipulated Water System Facilities Charge

Kealia Water initially proposes to assess each new customer a "Connection Charge" (renamed and hereafter referred to as WSFC) of \$5,000. Applicant derived this figure by dividing its OAC rate base total of \$1,070,936 by two hundred (200), its estimate of new customers in its Proposed Service Area.

The Consumer Advocate initially recommended that this proposed charge be disallowed.⁵⁵ Among other things, the Consumer Advocate reasoned that Applicant's owner would experience a financial windfall if more than two hundred (200) customers connected to the water system.⁵⁶ Additionally, the Consumer Advocate argued that utilizing a WSFC to recover the cost of plant could be discriminatory to certain new customers if Kealia Water terminates the WSFC once the total cost of the plant is recovered from the first two hundred (200) new customers, since those connecting on to the system at a later date would not be assessed the charge.

In response, Kealia Water amended its proposal by first clarifying that WSFC is intended to recover the cost of the replacement of the water system in an effort to keep rates for water service within reasonable levels. Kealia Water specifically agreed to only apply WSFC to the first two hundred and thirty-five (235) new connections⁵⁷ and also agreed to allocate a portion of the PST plant costs attributable to all existing and planned developments to rate base. Due to these changes, the proposed WSFC amount was reduced to \$3,700. More significantly, customers will not be assessed the WSFC.

⁵⁵See, Consumer Advocate's Direct Testimony at 37 and 50.

⁵⁶Based on its review of Applicant's water system, the Consumer Advocate estimated that the system could possibly serve another nine hundred (900) customers. See, Consumer Advocate's Direct Testimony at 36.

⁵⁷This amount represents Kealia Kai's thirty-five new planned units and an estimated two hundred (200) additional lots in the Proposed Service Area in the future.

Payment of WSFC will be made by the current developers in the Proposed Service Area or their successors (or assignees) as opposed to future customers. The owners of Kealia Kai and Kealia Plantation agreed to pay, or have their successors or assignees pay, the WSFC amount when connecting to the water system for service. This change with regards to the WSFC is reflected in Section 7.2 of the Parties' proposed rules and regulations for Applicant's water service. The Parties adopted the amendments detailed above. Specifically, the Parties stipulated to a WSFC amount of \$3,700 to be recovered in the manner set forth in Section 7.2 of the Parties' proposed rules and regulations for Applicant's water service, set forth in Exhibit C of the Stipulation.

3. Other Stipulated Related Matters

Aside from the rate base elements discussed above, the Parties also stipulate to an average accumulated depreciation amount of \$117,936 for the Test Year and \$235,872 at Full Build-Out. Additionally, the Parties stipulate to working capital amounts of \$5,013 for the Test Year and \$5,862 at Full Build-Out and agreed to reallocate costs for excavation, testing, and chlorination associated with various aspects of Applicant's water system as detailed on pages 28 and 29 of the Stipulation.

F. Stipulated Rate of Return

Kealia Water initially proposes a rate of return of negative one-hundredth of a percent (-0.01%) for the Test Year. However, in light of the stipulated adjustments to the various

elements and components of Applicant's results of operations, the Parties' stipulate to use a rate of return of negative three and eighty-eight-hundredths of a percent (-3.88%) and an estimated return of nine and fifty-four-hundredths of a percent (+9.54%) at Full Build-Out under the Parties' Stipulated Rates.

The rate of return for the Test Year of negative three and eighty-eight-hundredths of a percent (-3.88%) and an estimated nine and fifty-four-hundredths of a percent (+9.54%) at Full Build-Out were derived from various rate elements stipulated to by the Parties, including but not limited to those negotiations related to rate base, see discussions set forth above. Based on this understanding, the commission finds that the rate of return stipulated to by the Parties for the Test Year and at Full Build-Out is acceptable for the purposes of this proceeding.

G. Stipulated Rules and Regulations

Kealia Plantation expressed that Applicant's proposed initial rules and regulations "did not clearly set out the rights and obligations of the future consumers and developers with respect to Applicant's proposed services" and that in some instances, it appeared that Kealia Water could double charge for the same service.⁵⁸ To address this concern and for clarity and consistency, Kealia Plantation suggested various substantive and non-substantive revisions to Applicant's proposed initial rules

⁵⁸See, Kealia Plantation's Testimony at 3.

and regulations.⁵⁹ The Consumer Advocate also suggested various changes to Kealia Water's proposed initial rules and regulations.⁶⁰ Among other things, the Consumer Advocate suggested that Section 8.4 (Dishonored Checks) of Applicant's initial proposed rules and regulations be amended to specify the service fee for dishonored checks in accordance with its suggested language⁶¹ and to include a section regarding "Nonpayment of Bills" in Section 11 (Discontinuation of Service) of the document, which are commonly found in rules and regulations of other water utilities.⁶²

Through negotiation, the Parties reached agreement on a set of proposed rules and regulations that they believe "fairly balance the issues of consumers and developers with the needs of the Applicant to be flexible enough" to provide its water service in the Proposed Service Area.⁶³ The Parties attached their stipulated proposed rules and regulations for Applicant's water service as Exhibit C to the Stipulation.

Both Kealia Plantation and the Consumer Advocate were given an opportunity to fully express their concerns and suggest changes to Applicant's proposed initial rules and regulations for water service. Kealia Water's proposed initial rules and

⁵⁹See, Kealia Plantation's Testimony at 4 and Exhibits INT-101 and INT-102.

⁶⁰See, Consumer Advocate's Direct Testimony at 42-50.

⁶¹See, Consumer Advocate's Direct Testimony at 46-7.

⁶²See, Consumer Advocate's Direct Testimony at 48.

⁶³See, Stipulation at 31.

regulations appear to have been substantially revised during negotiations amongst the Parties. Based on our review of the agreed-upon rules and regulations set forth in Exhibit C of the Stipulation, the commission finds them to be reasonable for the purposes of this docket.

VI.

ULTIMATE FINDINGS AND CONCLUSIONS

The commission finds that the Stipulation, filed on June 9, 2005, balances the various interests and views of the Parties of this docket. We recognize that the Stipulation represents a compromise between the Parties and sets forth their global resolution of the issues of this proceeding. Upon evaluation and assessment of the provisions of the Stipulation and the full record established in this proceeding, the commission finds the Stipulation to be satisfactory and acceptable for the purposes of this docket. Accordingly, the commission concludes that the Stipulation should be adopted in its entirety. However, we make clear that our adoption of the Stipulation does not indicate our agreement with the underlying methodologies or justifications used to develop and arrive at the Stipulation. Our decision to adopt the Parties' Stipulation shall not be construed or interpreted as setting precedent regarding any issues addressed in this docket in any future matters before the commission.

With regards to specific provisions of the Stipulation, the commission finds and concludes the following:

1. Applicant is fit, willing, and able to properly perform as a water utility; conform to the terms, conditions, rules, and regulations adopted by the commission; and its proposed services are, or will be, required for the present and future public convenience and necessity. Accordingly, we conclude that Kealia Water should be granted a CPCN to provide water service in the District of Kealia, on the island of Kauai in the Proposed Service Area as described in its Application.

2. The Stipulated Rates, and agreed-upon charges, and proposed rules and regulations for Applicant's water service, are acceptable for the purposes of this docket.

3. The stipulated: (a) revenues; (b) operating expenses; and (c) other elements of Applicant's Revenue Requirements and Rate of Return schedule at Stipulated Rates for the Test Year and at Full Build-Out, as set forth in Exhibit I (attached), are also acceptable.

4. The stipulated total average rate base at Stipulated Rates for the Test Year and at Full Build-Out, as set forth in Exhibit B of the Stipulation, and the properties included in rate base, as stipulated to by the Parties, are acceptable for the purposes of this docket.

5. The stipulated rate of return on Applicant's rate base at Test Year and at Full Build-Out is acceptable for the purposes of this docket.

VII.

ORDERS

1. The Parties' Stipulation, filed on June 9, 2005, is approved in its entirety and is adopted as part of this Decision and Order.

2. Kealia Water is granted a CPCN to provide water service in the District of Kealia, on the island of Kauai in the Proposed Service Area as described in its Application.

3. Kealia Water's proposed rates and charges for water service, set forth in the Parties' Stipulation, are approved, and shall take effect on September 1, 2005; provided that Kealia Water complies with the orders set forth below. Kealia Water shall formulate a rate schedule reflecting the rates and charges approved in this Decision and Order and incorporate the rate schedule into its initial tariff.

4. Kealia Water's proposed rules and regulations for water service, as stipulated to by the Parties and attached to the Stipulation as Exhibit C, are approved, and shall take effect on September 1, 2005; provided that Kealia Water complies with the orders set forth below.

5. Kealia Water shall file with the commission and serve upon the Consumer Advocate its initial tariff, consisting of its rate schedule, charges, rules, and regulations for the provision of water service under its CPCN, consistent with the determinations of this Decision and Order. The initial tariff shall be filed within seven (7) days of the date of this

Decision and Order. In the event any tariff provision conflicts with State law, State law shall prevail.

6. Kealia Water shall notify its current "customers" of Applicant's certification as a public utility for water service, and the availability of Kealia Water's published rates, charges, and rules and regulations for providing water service, and provide them with a copy of its rate schedule as promptly as possible, but no later than August 22, 2005. Concurrently, sample copies of any such notice shall be filed with the commission and served on the Consumer Advocate.

7. Kealia Water shall file with the commission and the Consumer Advocate an annual financial report in accordance with the National Association of Regulatory Utility Commissioners' *Uniform System of Accounts - 1996*, covering its water utility services commencing with the year ending December 31, 2005, and each calendar year thereafter. The reports shall be filed no later than March 31 of each year, for the immediate past calendar year, with the first report due no later than March 31, 2006.

8. Within thirty (30) days of the date of this Decision and Order, Kealia Water shall remit a public utility fee of \$60, pursuant to HRS § 269-30(b). In addition, beginning July 31, 2006 and December 31, 2006, and each calendar year thereafter, Kealia Water shall pay a public utility fee which shall be equal to one-fourth of one percent (0.25%) of the gross income from its public utility business during the preceding

year, or a sum of \$30, whichever is greater, in accordance with HRS § 269-30(b).

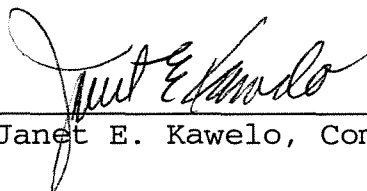
9. Failure to comply with any of the commission's orders, noted above, may constitute cause to void this Decision and Order and Applicant's CPCN, and may also result in further regulatory action as authorized by State law.

DONE at Honolulu, Hawaii August 16, 2005.

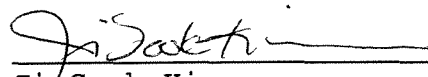
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By (Excused)
Wayne H. Kimura, Commissioner

By 
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:


Ji Sook Kim
Commission Counsel

03-0246.ah

DOCKET NO. 03-0246
KEALIA WATER COMPANY HOLDINGS
REVENUE REQUIREMENTS & RATE OF RETURN
TEST YEAR 2004 AND FULL BUILD OUT YEAR ENDED DECEMBER 31, 2006

	Approved Rates for Test Year 2004	Full Build Out 2006
Revenues	\$ 57,966	\$ 109,935
Operating Expenses		
Operations Contract	\$ 17,400	\$ 17,400
Electricity Expense	7,000	9,838
Insurance	13,650	13,650
Materials & Supply	1,000	1,000
Legal and Regulatory	3,400	3,400
Administrative Expense	12,000	12,000
Miscellaneous	2,000	2,000
Inflation from 2004 to 2006	-	3,611
Total Operating Expenses	\$ 56,450	\$ 62,899
Taxes, Other Than Income	\$ 3,701	\$ 7,019
Depreciation Expense - Net of Amortization	8,787	8,787
Income Taxes	-	5,851
Total Expenses	\$ 68,938	\$ 84,556
Net Operating Income	\$ (10,972)	\$ 25,379
Average Rate Base	\$ 282,835	\$ 266,113
Return on Average Rate Base	-3.88%	9.54%

Exhibit I

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21992 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

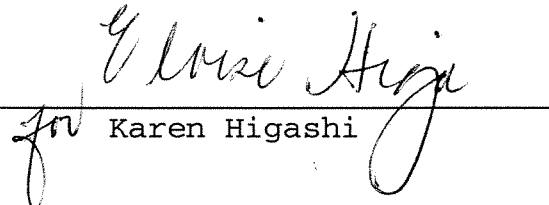
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

C. CLARK LIPSCOMB
PRESIDENT, REAL ESTATE DIVISION
CORNERSTONE HAWAII HOLDINGS, LLC
132 West Main Street
Aspen, CO 81611

J. DOUGLAS ING, ESQ.
PAMELA J. LARSON, ESQ.
WATANABE ING KAWASHIMA & KOMEIJI LLP
999 Bishop Street, 23rd Floor
Honolulu, HI 96813

JUSTIN HUGHES
KEALIA PLANTATION COMPANY, LLC
c/o Law Offices of Walton D.Y. Hong
3135-A Akahi Street
Lihue, HI 96766

CRAIG I. NAKANISHI, ESQ.
RUSH MOORE CRAVEN SUTTON MORRY & BEH
737 Bishop Street, Suite 2400
Honolulu, HI 96813


for Karen Higashi

DATED: August 16, 2005